

VZCZCXRO4136
PP RUEHIK
DE RUEHVI #1479/01 3241304
ZNR UUUUU ZZH
P 201304Z NOV 09
FM AMEMBASSY VIENNA
TO RUEHC/SECSTATE WASHDC PRIORITY 3655
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
INFO RUCNMEM/EU MEMBER STATES

UNCLAS SECTION 01 OF 02 VIENNA 001479

SIPDIS, SENSITIVE

TREASURY FOR OCC/SIEGEL AND OASIA/ICB/MAIER
TREASURY PASS TO FEDERAL RESERVE, FINCEN AND SEC/OIA

E.O. 12958: N/A
TAGS: EFIN AU
SUBJECT: Austria's Hypo Alpe Adria Bank in Trouble

REF: A) Vienna 1257; B) Vienna 1076; C) Vienna 484

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Sensitive but unclassified -- protect accordingly.

SUMMARY

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¶1. (SBU) Hypo Alpe Adria (HAA), Austria's sixth largest banking group, is in trouble again. According to media reports and leaked documents, HAA is undercapitalized and will need fresh equity of 1.5-2.0 billion Euros in time for a special general shareholder meeting December 10. A conflict has emerged between the bank's German majority owner (BayernLB), the province of Carinthia (a minority owner) and the GoA Finance Ministry over recapitalizing the bank again after a large injection last December. Since Carinthia has guaranteed a whopping EUR 18 billion of HAA liabilities -- much more than it can service without federal help -- the GoA has a large stake in keeping the bank going. END SUMMARY.

Insufficient Capital to Cover Big Losses

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¶2. (U) According to media revelations this week, Hypo Alpe Adria/HAA will fail to meet its regulatory capital minimum (4%) in the coming weeks, absent a large recapitalization. Austrian supervisors have reportedly pressured bank leadership to submit a turnaround plan (though neither Austria's Financial Market Authority nor central bank will comment publicly).

¶3. (U) A large bank with total assets of EUR 41.7 billion (as of 30 June 2009), HAA has lost ground rapidly. It reported a loss after taxes of EUR 520 million for 2008 and another EUR 162 million for the first half of 2009; an "asset screening" this month by PriceWaterhouseCoopers (ordered by majority owner BayernLB) apparently identified substantial additional problems, which will cause HAA to lose at least EUR 1 billion for 2009. Public revelation of PWC findings and disclosures by BayernLB have highlighted HAA's equity gap: the bank apparently needs at least EUR 1.5 billion to keep its Tier 1 capital ratio above the legally mandated minimum.

¶4. (U) HAA's recent losses stem from large write-downs of loans and leasing deals in Southeastern Europe -- where it was a relatively late entrant and loaned aggressively to expand. The bank loaned heavily to high-profile ventures in the tourism sector (large hotels along the Adriatic and in Austria) and made other bad bets, such as lending to now-bankrupt Croatian retail chain Pevec. According to reports, the PWC review found undisclosed losses in HAA's leasing business, losses which were not reflected on the bank's balance sheet.

A Troubled Legacy

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¶5. (SBU) Hypo Alpe Adria's problems stem in part from its history as the "house bank" of the Carinthia provincial government, during which time it lent heavily in support of flagship projects by now-deceased populist right-wing governor Joerg Haider (such as the Hypo Arena soccer stadium in Klagenfurt). The province managed to sell the bank to BayernLB at the peak of the financial bubble (May 2007), using the proceeds to support more political largess.

¶6. (SBU) Allegations of poor corporate governance and political influence have marred HAA since at least 2004. In 2006, Austrian regulators forced out the bank's management in connection with accounting abuses; in 2007, the bank was cited again for weak management. According to media reports, there were irregularities surrounding BayernLB's takeover of HAA. In October, both BayernLB and HAA headquarters were apparently searched (the results of which have not been disclosed).

Who Will Pay to Save Hypo?

¶7. (SBU) In November 2007, BayernLB pumped EUR 440 million into HAA; in December 2008, HAA was recapitalized with EUR 900 million from the Austrian government and EUR 700 million in fresh equity from BayernLB (the latter as part of a EUR 10 billion Bavarian state government rescue of BayernLB). As reported (reftels), HAA apparently cannot pay this year's coupon (EUR 72 million) on its existing GoA equity capital tranche.

¶8. (SU) BayernLB has indicated it will provide additional capital to HAA, but has conditioned that assistance on the Austrian government also providing a second capital injection. Until now, FinMin Proell has downplayed the HAA problem and pressured the bank's owners (including minority shareholders) to do more. HAA's largest minority shareholders -- the province of Carinthia via a holding company (12%) and Grawe insurance company (20%) -- have said they

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will not provide additional capital.

¶9. (SBU) As former majority owner and home of HAA's headquarters in Klagenfurt, the Carinthian provincial government has issued contingent guarantees for EUR 18 billion in HAA liabilities, a huge sum relative to the province's annual budget (about EUR 2 billion). Since the province would need federal help to service those guarantees in the event of HAA folding, the GoA will presumably do its best to avoid a collapse if possible.

COMMENT

¶10. (SBU) It is unclear how HAA "passed" the Austrian National Bank's stress tests this summer (as of 30 June 2009, HAA reported a Tier 1 capital ratio of 8.1%). Under EU competition policy rulings, BayernLB may be forced to sell off Hypo Alpe Adria over the next three years, as a condition for the state help that both BayernLB and Hypo Alpe Adria received early in the crisis. With mediocre assets and few buyers in the market, Hypo Alpe Adria has bleak future prospects and little or no access to private funding except via public guarantees (earlier this year, HAA had an "E-Plus" rating from Moody's).

¶11. (SBU) There are signs that the GoA will back troubled Hypo Alpe Adria in spite of its public pressure on the bank's owners. This past week, the GoA extended Austria's bank rescue package for another year (through December 2010) -- an indication that Hypo Alpe Adria (and perhaps other banks) could need additional help -- and GoA regulators consider Hypo Alpe Adria a "system-relevant" bank (basically "too big to fail"). For Austria, the potential cost of an HAA failure in terms of contingent guarantees remains greater than the cost of keeping it on life support -- it can only hope that HAA's German owners stay on board as well.

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